

Chapter: Introduction to Management Accounting

Today accounting is used as a tool in analysis of business and its activities. Accounting information is presented in different ways in order to help in analysis by the different users of the information. The two widely used types of accounting are:

- Financial accounting
- Management accounting.

Financial accounting is the presentation of accounting information for stakeholders and regulators. It presents the financial position for an entire time period. On the other hand, Management accounting is the presentation of analysis of business activities to the internal management to facilitate decision making.

Definition of MA:

The Institute of Cost and Management Accountants, London, has defined Management Accounting as: “The application of professional knowledge and skill in the preparation of accounting information in such a way as to assist management in the formulation of policies and in the planning and control of the operation of the undertakings.”

Basis for Comparison	Management accounting	Financial accounting
Purpose	It is used for internal purpose	It is used for external reporting primarily, although the management also reviews it
Regulation	It is not regulated by any law	It has to be presented as per standards
Users	Its users are the management of an organization	Its users are shareholders, investors and regulators
Objective	It aids in internal decision making	It aids in investment decision by outsiders and monitoring by regulators
Mandatory	Preparation and presentation of financial statements is not mandatory	Preparation and presentation is mandatory.
Audit	It is not subject to audit	Financial statements must be audited

Frequency	There is no defined frequency for preparation and presentation of the statements	Financial statements must be prepared for the financial year and presented
Contents	Management accounts include both monetary and non-monetary information	Financial accounts include only monetary information

What are the Functions of Management Accountants?

The functions of management accountants are dictated by their job positions, agreement with the organization, knowledge, and capabilities. On this basis, the tasks of a management accountant are briefly explained below:

1) Planning and Accounting

Management accountants prepare an accounting system covering costs, sales forecasts, profit planning, production planning, and allocation of resources. It should also include capital budgeting, short-term and long-term financial planning. They also prepare the procedures necessary to implement the plan effectively.

2) Controlling

Management accountants assist in the control of an organization's performance through the use of standard costing, accounting ratios, budget control, revenue and funds flow statements, cost-cutting initiatives, and assessing capital expenditure proposals and returns on investment.

3) Reporting

Management accountants assist the top management in finding out the root cause of an unfavorable operation or event by identifying the real reasons for the adverse events and as well as the responsible parties and comprehensively reporting them.

4) Coordinating

Management accountants improve an organization's efficiency and profits by providing various coordination tools such as budgeting, financial reporting, financial analysis and interpretation, and so on. These tools aid management by comparing cost and financial records, preparing financial budgets and establishing standard costs, and analyzing cost deviations to enable management by exception.

5) Communication

Management accountants create a wide range of reports to communicate results to superiors, inspire staff, retain effective control over their operations, and help management to make smart decisions. Through published financial statements and returns, they also inform the outside world about their company's success.

6) Financial evaluation and Interpretation

Management accountants analyze the data and present it to the management in a non-technical approach, together with their comments and ideas, so that the shareholders and senior management employees can understand it and make informed decisions.

7) Tax Administration

Management accountants are in charge of tax policies and processes. They make the reports that are required by various authorities available. Further, they establish enough tax provisions, ensuring that quarterly tax payments are made in advance, as required by the Income Tax Act, to prevent the payment of penal interest on late tax payments.

8) Evaluation of External Effects

There may be changes in government policy and even existing laws. These amendments and policy changes can affect business goals; Management accountants assess the extent of any impact of these external factors on the business and report it to the stakeholder to take necessary precautionary measures

9) Economic appraisal

When the government makes regular announcements about the country's economic situation, management accountants do an economic study and determine the influence of current economic conditions on the company's operations. They compile a report containing their observations and present it to high management.

10) Asset Protection

Management accountants separate fixed asset registers for each type and provide internal checks and controls to protect the company's assets. They also create the rules and regulations for each type of fixed asset and get insurance coverage for all types of fixed assets.

Scope of Management Accounting

Helps In Decision Making

Assisting in better decision making is an important role in Management accounting. It supports the decision-making process of the management team by informing them about all affairs of business from time to time. The right decisions taken at the right time can improve the efficiency of the business. Management accounting helps in understanding business problems in a better way using techniques from different fields like costing, statistics, economics, etc.

Controls Management Performance

Managerial control is another important objective of management accounting. The whole organization is divided into different responsibility centres and each responsibility center is allotted some goals to be achieved.

Management accountant monitors and evaluates the performance of these responsibility centers from time to time. He is responsible to check whether operations are going as per plans and standards. In case of any deviations, he will inform management thereby helping in taking corrective measures timely.

Proper Planning and Formulation Of Policies

Management accounting assists managers in making better plans and policies for the organization. It provides management of the financial reports containing all financial and statistical data about organization.

Information from various financial sources like cash flow statement, fund flow statement, capital budgeting, marginal and standard costing is presented in these financial reports. This all collectively helps managers in proper analysis and formulating of appropriate policies.

Interprets Financial Information

Management accounting interprets the financial information in a way that is well understood by management. Information collected through accounting is somehow technical and cannot be well understood easily until you have proper knowledge of accounting subjects. Management accounting derives information from various financial statements and presents it in the form of reports which contain information in non-technical and intelligible manner.

Motivates Employees

Motivation of employees is a must for the achievement of organizational goals timely. Management accountant sets goals and policies to be followed by each employee and department in an organization. It keeps a full check on the activities of employees and measures their effectiveness from time to time. In addition to measuring their performance, he also guides and supports them in improving their efficiency.

Evaluates Policies Effectiveness

Management accounting measures the overall efficiency of various policies taken by the management team. It assists and lay emphasis on Management audit. Management accounting reviews the performance and effectiveness of management policies in various departments. It finds out the deviations and communicates the same to management team.

What Are the Roles Of Management Accountants?

The management accounting role is broad and includes identifying and managing risk, analysing information, and using it to make business decisions, plans, and budgets. The roles of management accountants are:

1. To consult with the segments of management responsible for policies and procedures, and the effectiveness of those policies and procedures.
2. To make comparisons to the operational plan and standards, as well as to report and evaluate operational outcomes to all levels of management and the business owners.
3. Establish, coordinate, and execute an adequate plan for operation and control as an inherent aspect of management. To the extent required by business cost standards, such a plan would include spending budgets, profit planning, sales forecasts, and capital investment and financing program, as well as the procedures necessary to carry out the plan.
4. To ensure the financial security of the company's assets through effective internal controls and adequate insurance coverages.

Important tools and techniques used in management accounting

Some of the important tools and techniques are briefly explained below.

1. Financial Planning

The main objective of any business organization is maximization of profits. This objective is achieved by making proper or sound financial planning. Hence, financial planning is considered as best tool for achieving business objectives.

2. Financial Statement Analysis

Profit and Loss account and Balance Sheet are important financial statements. These statements are analyzed for different period. This type of analysis helps the management to know the rate of growth of business concern. This analysis is done through comparative financial statements, common size statements and ratio analysis.

3. Cost Accounting

Cost accounting presents cost data in product wise, process wise, department wise, branch wise and the like. These cost data are compared with predetermined one. This comparison of two costs enables the management to decide the reasons responsible for the difference between these costs.

4. Fund Flow Analysis

This analysis find out the movement of fund from one period to another. Moreover, this analysis is very useful to know whether the fund is properly used or not in a year when compared to the previous year. The working capital changes and funds from operation are also find out through this analysis.

5. Cash Flow Analysis

The movement of cash from one period to another can be find out through this analysis. Besides, the reasons for cash balance and changes between two periods are also find out. It studies the cash from operation and the movement of cash in a period.

6. Standard Costing

Standard costing is predetermined cost. It provides a yard stick for measuring actual performance. It is used to find the reasons for the deviations if any.

7. Marginal Costing

Marginal costing technique is used to fix the selling price, selection of best sales mix, best use of scarce raw materials or resources, to take make or buy decision, acceptance or rejection of bulk order and foreign order and the like. This is based on the fixed cost, variable cost and contribution.

8. Budgetary Control

Under Budgetary control techniques, future financial needs are estimated and arranged according to an orderly basis. It is used to control the financial performances of business concern. Business operations are directed in a desired direction.

9. Revaluation Accounting

The fixed assets are revalued as per the revaluation accounting method so that the capital is properly represented with the assets value. It helps to find out the fair return on capital employed.

10. Decision-making Accounting

A business problem can be solved by choosing any one of the best and most profitable alternative. To select such alternative, the relevant costs are compared. Thus, accounting information are used to solve the business problem which are arising out of increasing complexity of nature of business.

11. Management Information System

The free flow communication within the organization is essential for effective functioning of business. Hence, the management can design the system through which every employee of an organization can assess the information and used for discharging their duties and taking quality decisions.

12. Statistical Techniques

There are a lot of statistical techniques used in removing management problems. Methods of least square, regression and quality control etc. are some examples of statistical techniques.

13. Management Reporting

The management accountant is preparing the report on the basis of the contents of profit and loss account and balance sheet and submit the same before the top management. Thus prepared reports disclose the strength and weakness indifferent areas of operating activities and financial activities. These identification are highly useful to management for exercising control and decision-making.

14. Historical Cost Accounting

It means that costs are recorded after being incurred. This is used for comparing with predetermined costs to evaluate performance.

15. Ratio Analysis

It is used to management in the discharge of its basic functions of forecasting, planning, coordination, communication and control. It paves the way for effective control of business operations by undertaking an appraisal of both the physical and monetary targets.